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UNCLAS SECTION 01 OF 02 WELLINGTON 000010

SIPDIS

SENSITIVE

STATE FOR EB/ESC/IEC AND EAP/ANP
COMMERCE FOR 4530/ITA/MAC/AP/OSAO/GPAINE

E.O. 12958: N/A
TAGS: ECON NZ ENGR
SUBJECT: INDUSTRY MAY FOOT BILL FOR COST OF BOOSTING NEW ZEALAND'S OIL RESERVES

REF: 04 WELLINGTON 291

(U) Sensitive but unclassified -- protect accordingly. Not for Internet distribution.

¶1. (SBU) Summary: Oil companies are facing the prospect of shouldering the costly burden of bringing New Zealand's oil stocks up to an international standard. With the country's reserves well below the 90-day supply recommended by the International Energy Agency (IEA), New Zealand's Cabinet has decided to impose the expense of expanded oil stockpiles on the four major oil companies and one independent company operating in New Zealand. The companies say that if the government wants to meet the IEA standard, then it should bear the cost. In addition, they contend that if the government allowed the market to work, oil supplies would be adequate. The government will accept comments until February 2 on a study it commissioned on the matter and then is expected to decide how it directs the stockpiling of oil. The two U.S. companies have not yet requested U.S. government advocacy of their position, but have asked that post continue to monitor the issue. End summary.

¶2. (U) While New Zealand depends on imports for about 80 percent of its oil consumption, the government does not hold any reserves or require oil companies to maintain stockpiles. However, New Zealand relies on industry stockpiles to meet its obligation as a member of the IEA to hold 90 days of oil reserves. With the country now holding less than 60 days' supply, it must arrange storage of about 500,000 additional tons of oil to meet the IEA target, according to the government-commissioned study released December 14. The study was launched in October after the government learned of New Zealand's shortfall, which was caused by inaccurate accounting of stockpiles and declining domestic production.

¶3. (U) The report estimates the cost of building storage tanks and acquiring the extra oil to meet the IEA target would be NZ $640 million (US $448 million) in 2006. Inventories would have to be increased about 62 percent and capital investment raised about 26 percent. In a statement accompanying the study, then Minister of Energy Hodgson said, "Cabinet has decided that oil companies should be responsible for providing adequate stocks, not the taxpayer." (In an unrelated Cabinet reshuffle December 20, Trevor Mallard was named energy minister.) The study expects the industry would pass the added costs to end-users, but this would raise pump prices no more than NZ 1 cent per liter.

¶4. (SBU) Oil companies disputed the cost estimates, contending that the industry and ultimately consumers would pay more. Mobil Oil New Zealand estimates the expense to each large oil company would be NZ $100 million to NZ $150 million, which would increase Mobil's working capital requirements in New Zealand by 25 to 50 percent. Caltex New Zealand said the estimates do not include the cost of land for new storage tanks and maintenance. Two other large oil companies, BP New Zealand and Shell New Zealand, and an independent company, Gull, operate in the country.

¶5. (SBU) Peter Thornbury, public affairs manager for Mobil Oil New Zealand, said the government confused the issue of security of supply with meeting the IEA target. As the study noted, the oil companies in the country have operated on "sound commercial lines," maintaining reserves that have not compromised supply to their customers. Peter Doolan, president of the ExxonMobil Refining and Supply Division in Singapore, said that if the government wants additional stockpiles, it -- and not private industry -- should fund them.

¶6. (SBU) Separately, John Kerr, public affairs manager of Caltex New Zealand, said the government's desire to meet the IEA target is based on a "societal" assessment of the level of adequate reserves, rather than on a commercial view of the possibility of disrupted oil supplies. Kerr asserted that an interruption of oil supplies from the Middle East over a long period of time -- the study's key scenario -- is unlikely.

¶7. (SBU) New Zealand is unique among IEA members in being

heavily dependent on distant imports, Thornbury and Kerr noted. A long supply chain -- between 25 to 30 days from Middle East suppliers and between 15 to 20 days from Far East suppliers -- means that in-transit oil supplies might be considered as reserves. They suggested the government seek the IEA's concurrence to count stocks in transit toward the reserves requirement. This would enable New Zealand to satisfy the 90-day target without constructing additional storage. The study, however, takes the opposite view: The long supply chain increases New Zealand's vulnerability to oil shortages. The four major companies import mostly crude petroleum that must be processed at New Zealand's sole refinery. Gull imports refined products.

¶8. (SBU) The study also cites the need for official oversight of storage levels, for monitoring compliance and for implementing a penalties regime. Companies expressed a wariness of increased regulation of their industry.

¶9. (U) Minister Hodgson described the required 90-day reserve as a "sensible precaution." He called on the government to consider even larger stockpiles, allowing New Zealand to draw from them rather than having to restrict demand during a supply disruption. The study did not analyze the benefits of membership in the IEA, which New Zealand joined in 1976.

¶10. (SBU) Comment: Despite the expected rise in gas prices -- which already went up 12 percent in September over the past year -- a decision to boost oil stockpiles is not a politically difficult one for the government in this election year. It is the oil industry that likely will take the blame for a price bump caused by plumping the oil reserves. Directing oil stockpiling also would be consistent with the government's increasing intervention in the energy sector. This effort, sparked by its desire to ensure adequate energy supplies, has in the past year included re-regulating the electricity sector, instituting incentives for gas exploration and entering a risk-sharing agreement with a state-owned enterprise to get a new power project off the ground.
Swindells